Campbell Johnston Clark

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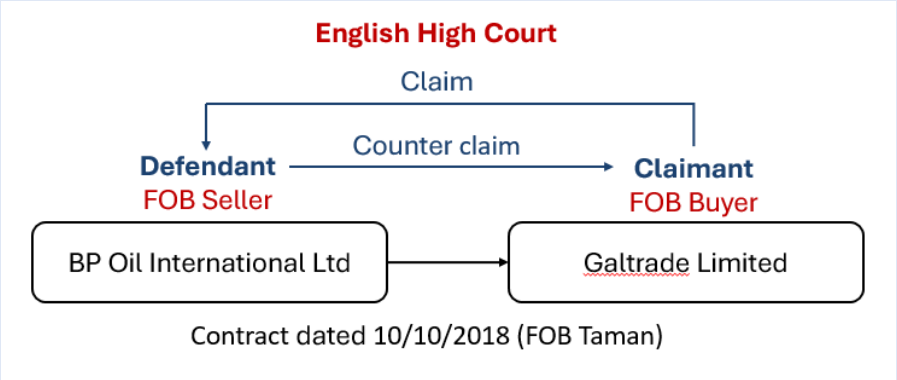
When is a buyer entitled to reject cargo for off-specification?

*This question arose in the High Court case Galtrade Ltd v BP Oil International Ltd [2021] EWHC 1796 (Comm). **David Owens**, Director, and **Cecilie Rezutka**, Associate at CJC, consider implications arising.*

Overview

A recent case from the High Court gives valuable guidance on a fundamental question for parties to commodity sale and purchase contracts: when can a buyer reject off-specification goods? In this case, the Court held that even though a parcel of straight run fuel oil was off-spec for sulphur content, the Buyer was still not entitled to reject the cargo. As such, not only did the Buyer's claim for damages fail, but the Seller's counterclaim against the Buyer for the Buyer's failure to take delivery would have succeeded had the Seller been able to persuade the Court the Seller had suffered any actual loss.

The contractual background was as follows:



Background

Defendant seller BP Oil International Limited (the **"Seller"**) agreed to sell and claimant buyer Galtrade Limited (the **"Buyer"**) agreed to buy 4 parcels of low sulphur Straight Run Fuel Oil (SRFO) on FOB Taman, Black Sea coast terms pursuant to a sale contract (the **"Contract"**), incorporating the BP General Terms and Conditions for Sales and Purchases of Crude Oil and Petroleum Products 2015 (the "**BP General Terms**"). The Contract further contained detailed quality specifications in the usual way which set a maximum level of, amongst others, sulphur.

Of the four parcels, parcels 1 and 2 were off-specification, but a commercial agreement was reached between the parties. The dispute concerned Parcel 3.

Both parties agreed that parcel 3 contained a sulphur content of 1.53%, against the maximum contractual sulphur content of 1.3%, and that the Seller was therefore in breach of contract.

The parties however disagreed as to the consequences of this breach. The Buyer rejected parcel 3 for non-conformity with the Contract and claimed for wasted expenses incurred in dealing with parcel 3.

The Seller agreed to take back the product but claimed in turn that the Buyer had in fact no right to cancel. The Seller held the Buyer to be in repudiatory breach of contract, and counter claimed for wrongful rejection of the cargo and/or further breaches for failure to pay for the cargo.

High Court Proceedings

Condition v Innominate Term

The Court considered whether the quality specifications in the Contract were to be classified as a condition or as an intermediate term. If classified as a condition, any breach, no matter how serious, would entitle the Buyer to terminate the Contract and recover damages. If classified as an innominate term, only a breach which deprived the Buyer of substantially the whole benefit of the contract would entitle them to cancel the Contract (*Hongkong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd (The Hongkong Fir)* [1962] 2 Q.B. 26). The Buyer would then be obliged to take delivery of the cargo but claim damages for the Seller's breach.

The Court held that the quality clause was an intermediate term, for the following reasons:

1. the contractual terms did not provide for an automatic right to reject in case of a breach and the words *"shall not be inferior"* in the Contract were insufficient to make the specified sulphur level a condition of the Contract;
2. the specifications were standard quality specifications, rather than part of the description of the product;
3. classifying the quality of a naturally occurring product as a condition would have unintended commercial consequences;
4. the specifications did not mark a clear watershed between the acceptable and unacceptable and parcel 3 remained usable as a blend stock;
5. there was no market expectation that a breach would give rise to a right to reject the cargo;
6. the very nature of the parties' business included dealing with off-spec cargoes which remained marketable. Here, the cargo remained marketable, albeit at a reduced price; and
7. case law[1] leans in favour of treatment as intermediate terms over conditions.

As the Court held that the specifications in the Contract constituted an innominate term and not a condition, the next question was whether the breach was sufficiently serious that the Buyer was entitled to reject the goods and bring the Contract to an end.

Decision

The Court held that the Buyer was not entitled to reject the cargo, as the breach was insufficiently serious. The Court held that the delivered cargo containing 1.53% sulphur was not a substantively different product to a cargo with 1.30% sulphur. The cargo remained useful and marketable, at an appropriate price. The Buyer was therefore not deprived of substantially the whole benefit of the Contract. The rejection of the cargo was therefore a repudiatory breach of the Contract by the Buyer.

Furthermore, it followed that the Buyer's claim for wasted expenses failed. The wasted expenses arose from the Buyer's wrongful decision to reject the cargo, and not from the Seller's breach in tendering an off-spec cargo.

It is notable that the Judge also took account of the fact that the Buyer's initial reaction on discovering that the cargo was off-spec was not to definitively state that the cargo would be rejected, but instead to ask for a price discount.

In other words, the Buyer's conduct appeared to show that their main concern was price, and not that there had been a fundamental breach of Contract.

The Seller's counterclaim for losses caused by the Buyer's failure to take delivery of the cargo also succeeded in principle. However, the Court found that the Seller had in fact suffered no loss, and therefore the Seller recovered only nominal damages.

CJC Perspective

1. The case serves as a useful reminder of the pitfalls of rejecting goods when not entitled to do so. A party should exercise caution to ensure that a contract can legitimately be brought to an end and the cargo rejected. Unless the contract clearly provides otherwise, the mere fact that a cargo is off-spec may not be sufficient to allow a buyer to cancel the contract. Where the right to reject a cargo is unclear, a buyer may find it safer to accept the cargo, but bring a subsequent damages claim.

2. However, it would equally be wrong to assume that a buyer can never terminate a sale contract due to non-compliance with product specifications. The nature of the cargo and marketability of the off-spec product played an important role in the Judge's decision. A different conclusion may well have been reached if the product was sufficiently off-spec that, for example, it would fall on the other side of a division between different industry standard commodities (for example, as between low sulphur fuel and high sulphur fuel).

3. This is therefore a complicated area, and it is particularly important that if a buyer wishes to cancel a contract due to a cargo being off-spec, legal advice should be sought promptly beforehand to minimise the risk of being found in wrongful repudiation of the contract. Whether to reject goods is a careful balancing act. This case shows that cancelling a contract where there is no right to do so may both leave a buyer with unrecoverable losses, and also exposed to any losses suffered by the seller.

4. Furthermore, legal advice may assist a party in finding an acceptable commercial solution without compromising any rights. As stated above, the Judge was supported in finding that there was no fundamental breach of contract by the fact that the Buyer was willing to take the cargo and accept a price discount. Future buyers in a similar situation may wish to make any proposals for a price discount in the form of a "without prejudice" settlement offer, with the aim of avoiding such correspondence being relied upon by a seller in future proceedings.

5. Fundamentally however, parties to a contract are free to agree that a buyer should be entitled to reject a product if it is off-specification. If parties wish for a contractual term to constitute a condition the breach of which gives rise to a termination of the contract, this should be made clear in the wording of the relevant clause.[2] If any specifications constitute a 'red line' for a buyer therefore, the buyer should make clear in the relevant contract that strict compliance with such specifications is a contractual condition.

[1] See for instance *The Hansa Nord* [1975] 2 Lloyd's Rep 445, at p 467 and *Tradax International SA v Goldschmidt SA* [1977] 2 Lloyd's Rep 604, at p 612.

[2] *Spar Shipping AS v Grand China Logistics Holding (Group) Co Ltd* [2016] EWCA Civ 982.

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